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6Estoppel doctrine applied to claims made policyDon R. Sampen

Insurance Matters

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The 1st District Appellate Court recently held that an insurer could be estopped from raising coverage defenses under a claims made policy where the insurer denies coverage without filing a declaratory judgment action, due to an insured's failure to report a claim in a timely manner during the policy period. *Uhlich Children's Advantage Network v. Nation Unition Fire Company of Pittsburgh, PA*, 2010 WL 395645 (1st Dist. Feb. 3, 2010).

The insureds, UCAN and its officer Darlene Sowell, were represented by James T. Derico Jr., and Mary Schulz of Derico & Associates P.C., Chicago. Zacarias R. Chacon and Leena Soni of Lewis Brisbois Bisgaard & Smith LLP, Chicago, represented the insurer, AIG and its affiliates.

AIG issued claims made D&O coverage for UCAN and its officers and directors for two policy periods, from July 2004 to July 2005 and from July 2005 to July 2006. The two policies provided, among other things, that notice of any claim had to be given AIG "as soon as practicable" either during the policy period or within 30 days after the end of the period.

The policies also required the insureds to give notice of any circumstances that could reasonably be expected to give rise to a claim. In addition, they stated that AIG "does not assume any duty to defend" but that the insureds nevertheless had "the right to tender the defense of any claim to the insurer" within 30 days of the date a claim was first made.

In January 2005, during the first policy period, a former employee of UCAN filed a claim with the Equal Employment Opportunity Commission alleging that UCAN discriminated against him in violation of the Americans With Disabilities Act (ADA). He amended his claim in July 2005, during the second policy period.

The EEOC subsequently issued the employee a right-to-sue letter, and he filed a federal lawsuit against UCAN and Sowell in October 2005. UCAN notified AIG of the lawsuit the same date it received a copy of the complaint. AIG denied coverage in March 2006.

About two years later, in February 2008, UCAN brought the instant declaratory judgment action alleging that AIG breached its duty to defend and claiming sanctions under section 155 of the Illinois Insurance Code. AIG moved to dismiss on the ground that the claim against UCAN and Sowell was first made in January 2005 and not reported until more than 30 days after the close of the first policy period. The trial court allowed the motion, and UCAN and Sowell took this appeal.

In an opinion by Justice Michael J. Murphy, the 1st District affirmed in part and reversed in part. Murphy first addressed the claim against Sowell. AIG contended that, as an insured under the policies, she was put on notice that she was likely to be sued when the disgruntled employee filed his amended EEOC claim in

July 2005, and that it had no duty to defend because it did not receive notice until October 2005.

Murphy pointed out, however, that while the amended EEOC claim did reference Sowell, the charge could not have made a claim against her because ADA claims may not be brought against officers of a corporation. Thus, the claim against Sowell was first made when the federal lawsuit was filed, and UCAN provided notice the same day.

Murphy also rejected AIG's argument under *American Center for International Labor Solidarity v. Federal Insurance Co*., 518 F. Supp. 2d 163 (D.D.C. 2007), that the claim against UCAN in January 2005 so related to Sowell as to constitute a claim against her, on the ground that the holding in that case was based on an "interrelated wrongful act" clause, which was absent from the AIG policy.

Accordingly, Murphy said, AIG had a duty to defend Sowell since her notice was timely.

As to UCAN, Murphy disagreed with the plaintiffs that AIG had a duty to defend it based simply on the fact that AIG had a duty to defend Sowell in the same underlying lawsuit. Murphy construed Illinois law as allowing coverage to be excluded as to one insured and remain in effect as to another.

Nevertheless, Murphy found that AIG had a duty to defend UCAN based on the estoppel principles of *Employers Insurance of Wausau v. Ehlco Liquidating Trust*, 186 Ill. 2d 127 (1999). He construed *Ehlco* as rejecting earlier case law holding that an insured's breach of the timely notice requirement under a policy negates the insurer's duty to defend. Rather, *Ehlco* held that even if an insurer believes that notice is late, it must still defend under a reservation of rights or file a declaratory judgment action, at the peril of being estopped from raising coverage defenses.

AIG contended that *Ehlco* was decided in the context of an occurrence policy, not a claims made policy, and that coverage does not typically exist under a claims made policy unless the claim is both made and timely reported during the policy period. Under *United Stationers Supply Co. v. Zurich American Insurance Co*., 386 Ill. App. 3d 88 (1st Dist. 2008), moreover, AIG argued that *Ehlco's* estoppel doctrine does not apply unless the purported insured is actually an insured.

Murphy agreed that UCAN had not provided timely notice to AIG as required by the first policy. He further found, however, that there was nothing in *Ehlco* limiting the estoppel doctrine to occurrence-based policies and that the doctrine there was held to have broad application. Accordingly, he said, but for *Ehlco*, AIG would have no duty to defend UCAN.

Still, he said the first policy was in effect when UCAN first received notice, and that UCAN also was an insured under the second policy when notice was given to AIG. These circumstances required AIG either to defend UCAN or file a declaratory judgment action.

AIG further argued that, for the duty to defend to apply, the policies required that it be given notice within 30 days of the claim being made, in writing, and that UCAN never tendered its defense in writing. Murphy rejected this argument on the grounds that UCAN had forwarded a copy of the federal court complaint, which sufficed as a writing, and that, moreover, actual notice of the claim to AIG was sufficient to trigger its obligation to defend.

AIG also contended that it did, in fact, seek a declaration of its rights under the policy, in response to the plaintiffs' declaratory judgment action. Murphy noted, however, that the plaintiffs' declaratory judgment

action was filed two years after AIG denied the claim, which was not sufficiently timely for AIG to avoid application of the estoppel doctrine.

Finally, with respect to the plaintiffs' request for sanctions under section 155, Murphy noted that that section applies only to vexatious and unreasonable conduct by an insurer, that it would not apply where the insurer has a bona fide defense to coverage, and that AIG's defense here gave rise to a genuine dispute regarding coverage. The plaintiffs therefore were not entitled to section 155 sanctions.

The court therefore reversed on the duty to defend, but affirmed with respect to the inapplicability of section 155 sanctions.
